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**ACCOUNTING**

# Architecture and Engineering Firms Can Use Tax Strategies to Free Up Cash

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Nov. 21, 2017



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When working with your external tax and financial advisors, try to identify ways beyond the normal cash management of the firm operational expenses, owner compensation, and bonuses to accelerate the timing of deductions. Using strategies like [bonus depreciation](#), [expensing qualified equipment](#), or [cost segregation](#) studies on owned buildings or significant leasehold interests can provide strategic tools for your firm. The goal is to improve the present value of the post-tax cash flow to the firm and its owners.

In conjunction with traditional [tax planning](#), several specialized tax strategies apply to architecture and engineering firms and can provide tax deductions or tax credits. Whether a firm and its owners can utilize these strategies depends on a number of factors, including the type of projects and clients the firm has, the level of unique design processes the firm employs, the type of contracts the firm has with its clients, and whether the firm practices [internationally](#).

In addition to the tax benefits, these strategies encourage energy efficiency, sustainability, improved building performance, and innovative, unique, and functional design. The following is a general overview of some of the opportunities available.

## **Commercial energy efficiency studies for government buildings (Section 179D deduction)**

The [Section 179D deduction](#) (currently expired with prospects of renewal) is available to the primary designer of the technical specifications for certain [energy efficient building systems](#) placed in service in the renovation or new construction of government-owned buildings.

Building systems that qualify include:

- Interior lighting systems
- HVAC
- Building envelope

The governmental entity, which is not a tax-paying entity, must assign the tax benefits in writing to the firm that designed the building systems.

Independent testing must be done using approved U.S. Department of Energy modeling software to certify the energy efficiency as measured against a base building using ASHRAE building standards. If certified, a tax deduction ranging from \$.45-\$1.80 per building square foot is available to the architecture and engineering firm designer, depending upon the energy savings achieved.

## **Research and development (R and D) tax credit studies**

Many firms engaged in systematic research may be able to [claim a tax credit](#) generally ranging from 14 – 20 percent of qualifying wages, consumed supplies, and contractor costs above a certain threshold that are associated with qualifying [activities of research and experimentation](#) on unique design processes or products.

Qualifying activities include the search for new engineering solutions, prototyping, and testing. This includes systematic trial and error coupled with success or failure testing that works to eliminate uncertainty. “Uncertainty” means the information available to you does not establish the capability or method for developing or improving the product or appropriate design of the product. The research doesn’t have to be unique and new to the world, just unique and new to you.

Although this is available on lump-sum and fixed-price client contracts, the IRS has repeatedly disallowed “cost plus time and materials” contracts, and guaranteed maximum price contracts.

Recent legislation permits the R and D credit for eligible small businesses to offset the Alternative Minimum Tax (AMT), and for certain qualified small businesses, it may offset payroll taxes.

Both the R and D credit and the 179D deduction can free up cash to be used for growth and debt reduction, and the savings can then be converted into dividends or distributions. The result provides owners with cash at a significantly lower effective tax rate than compensation. Both can also be retroactively claimed through amended return filings.

## **Interest Charge-Domestic International Sales Corporation (IC-DISC)**

An [IC-DISC](#) is a great way to create a permanent tax savings of 20 percent or higher for the owners of an architecture and engineering firm on a portion of the firm’s international activities. An IC-DISC is a separate “paper” corporate entity established by a U.S.-based architecture and engineering firm or some of its owners that has no impact on the way the firm does business (the owners of the IC-DISC do not have to be the same owners of the architecture and engineering firm).

[IC-DISC benefits](#) apply to qualifying engineering and architectural services performed outside the United States, such as:

- Site preparation

- Equipment installation
- Erection, expansion, and major repair of buildings, roads, dams, canals, bridges, tunnels, pipelines, and railroad tracks

With an IC-DISC, the architecture and engineering firm pays tax deductible commission expense to the IC-DISC (subject to certain dollar limitations). The IC-DISC pays no tax on the commission income received, and it distributes earnings to its shareholders taxed at qualified dividend tax rates. These benefits are only available after the IC-DISC is established.

## 179D deduction and R and D tax credit will be extended

Although the 179D deduction expired for property placed in service after December 31, 2016, we fully expect it will be extended by Congress.

Proposed changes for the extension of the 179D deduction include:

- Updating the current building standard, which will make it more difficult to qualify, and push the drive for better energy efficiency, which is in line with the goal of carbon neutrality via the [2030 Challenge](#).
- Expanding the current type of qualifying building to include 501(c)(3) charities and tribal governments.
- Possibly converting the current tax deduction to a tax credit.

## How we can help

CLA works with more than 400 architectural, engineering, and design firms nationwide. Our federal tax professionals have the technical experience to [provide support to firms](#) interested in R and D tax credits, energy efficient building deductions, and the benefits of the IC-DISC designation. To most effectively use these unique tax strategies, you may need to modify your current compensation and bonus systems.

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